JOINT COMMITTEE ON TAXATION
JCX-19-86
August 4, 1986

TECHNICAL AND STRUCTURAL DETAILS OF HOUSE OFFER

TITLE I--INDIVIDUAL TAX PROVISIONS

I.A.1. Tax Rate Schedules (pp. 1-2)

b. Rate adjustment.--House recedes, with a technical amendment providing that in separate returns of married individuals, the phaseout is computed with respect to the joint return 15% bracket amount.

c. Effective date.--House recedes, with an amendment providing relief from the individual rate stagger as follows for 1987:

(1) Rate schedules.--The new rate schedules provided by the Senate bill are effective on January 1, 1987, i.e., for the full year. For 1987 only, two additional rates are provided. A 35-percent rate begins at taxable income of $50,000 for joint returns ($25,000 for married filing separately); $45,000 for heads of households; and $30,000 for singles. A 40-percent rate begins at taxable income of $100,000 for joint returns ($50,000 for married filing separately); $85,000 for heads of households; and $60,000 for singles.

(2) Phaseouts.--There are no phaseouts of lower brackets or of personal exemptions for 1987.

(3) Standard deduction.--For 1987, the standard deduction amount is $4,600 for married individuals filing jointly ($2,300 if filing separately); $4,100 for heads of households; and $2,800 for single individuals.

(4) Exemption.--As in the Senate bill, the personal exemption amount is $1,900 for 1987.

(5) Capital gains.--As in the Senate bill, capital gains are taxed for 1987 as ordinary income to the extent that the applicable rate does not exceed 27%.

I.E.1. Meals, Travel, and Entertainment (p. 11-13)

a. Senate recedes, with modifications for deductibility of business meals (1) conforming the business purpose standard to that for other entertainment expenses (i.e., by

deleting the additional requirement that the business discussion must concern a specific transaction), (2) retaining present law regarding substantiation of meal expenses under $25, and (3) applying the same general fraud and negligence penalties to meals that apply to other entertainment expenses.

I.E.2. Employee business expenses, investment expenses, and other miscellaneous itemized deductions (p. 14-15)

a. Senate recedes, with amendment providing an increased floor of two percent of AGI, with exceptions to the floor for certain adjustments where a taxpayer restores amounts held under claim of right (Code sec. 1341), amortizable bond premiums (sec. 171), certain costs of cooperative housing corporations (sec. 216), and expenses of short sales in the nature of interest, and with a clarification that the floor does not affect trustee fees or administrative costs incurred by RICs (mutual funds) or REITS.

TITLE II--CAPITAL COST PROVISIONS

II.A.1.a. Cost Recovery Classes (p. 16):

3-year 200% Class	ADR midpoints of 4 years and less, except excludes automobiles and light trucks.
5-year 200% Class	ADR midpoints of more than 4 years and less than or equal to 8 years, and adding automobiles, light trucks, race horses, clothing held for rental, qualified technological equipment, and computer-based central office switching equipment.
7-year 200% Class	ADR midpoints of more than 8 years and less than or equal to 12 years, including property with no ADR midpoint not classified elsewhere.
10-year 200% Class	ADR midpoints of more than 12 years and less than 20 years, and adding single-purpose agricultural or horticultural structures.
15-year 200% Class	ADR midpoints of 20 years and less than 25 years, including

	sewage treatment plants, and telephone distribution plant and comparable equipment used for the transmission of information.
20-year 150% Class	ADR midpoints of 25 years and more, other than real property, and including sewer pipes.
30-year Straight-line Class	Real property not classified elsewhere.

II.A.1.b. Classification of special types of property (p. 19):

(xv) p.20: Equipment used by nontelephone companies which is comparable to distribution plant used by telephone companies for the transmission of information will be treated comparably (i.e., 15-year class).

New items:

(a) Reassignment of ADR midpoint:

Assign 6-year ADR midpoint for computer-based central office equipment.

Assign 5-year ADR midpoint for clothing held for rental.

Assign 19-year ADR midpoint for single-purpose agricultural or horticultural structures.

Assign 24-year ADR midpoint for telephone distribution plant.

(b) Create ADR midpoint for assets that presently have none.

Assign 5-year ADR midpoint to race horses.

Assign 24-year ADR midpoint to sewage treatment plants.

Assign 50-year ADR midpoint to sewer pipes.

II.A.1.c. Luxury Cars (p.20)

House recedes.

II.A.1.d. Changes in Classification (p.20)

Senate recedes.

II.A.2.a. Alternative Cost Recovery System (p.21)

(i)(A) Recovery period for property used outside the United States, tax-exempt entity leased property, for earnings and profits and for minimum tax provisions.

House recedes, except retain use of ADR midpoint for over-the-road tractor units.

(B) Recovery Period for Tax-exempt Bond Financed Property:

House recedes to Senate with the following modifications:

Delete special rule for solid waste disposal facilities and hazardous waste treatment facilities.

Low-income housing will be depreciated over the same period as for regular depreciation.

II.A.2.b. Presidential Authority

House recedes to Senate (spreadsheet shows same in both bills)--Senate does not allow authority to alter depreciation of previously ordered assets.

II.A.2.c. Space Property (p. 21)

Same in both bills.

II.A.3. Indexing (p. 21)

House recedes.

II.A.4.a. Half-year Convention (p. 22)

Same in both bills.

II.A.4.b. Mid-month Convention (p. 22)

House modification to apply mid-month convention only to real property and to apply mid-quarter convention to taxpayers who place more than 40 percent of property in service during the last quarter of the taxable year.

II.A.5. Gain on Disposition (p. 22)

House recedes.

II.A.6. Lessee leasehold improvements (p. 23)

House recedes.

II.A.7. Repair Allowances (p. 23)

Same in both bills.

II.A.8. Expensing (p. 23)

House recedes with modification that the expensed amount is limited to income derived from any active trade or business.

II.A.9. Vintage Accounts (p. 23)

Same in both bills.

II.A.10. Normalization (p. 24)

Same in both bills.

II.A.11. Effective Date (p. 24)

Generally, depreciation provisions effective January 1, 1987.

Taxpayers may elect new depreciation rules on property placed in service after July 31, 1986, if such property is not ITC transition rule property.

TITLE III--CAPITAL GAINS AND LOSSES

III.A. and B. Individual and Corporate Capital Gains (p.38)

House recedes with respect to individual capital gains; Senate recedes with respect to corporate capital gains; section 1231 capital gains treatment repealed.

TITLE IV--AGRICULTURE, TIMBER, ENERGY AND NATURAL RESOURCES

IV.A.1.b. Fertilizer and soil conditioning expenditures (p. 40)

Senate recedes with a clarification that expenditures not related to annual crop production are capitalized and amortized ratably over the period during which they benefit production.

IV.A.4. Prepayments (p. 41)

House recedes with a modification providing that the limitation applies to prepaid expenses to the extent they exceed 50% of expenses for which economic performance has occurred.

IV.C.2. Depletion--Oil and Gas (p.45)

Clarify that depletion for natural gas from geopressurized brine is phased out the same as other natural gas.

IV.D.1. Exploration and Development Costs (p.46)

Senate recedes with technical drafting clarifications.

IV.D.2. Depletion -- Hard Minerals (p. 46)

Senate recedes, with amendment to conform bill language to spreadsheet description of treatment of agricultural minerals and dimension stone.

IV.E.3. Credit for fuels from nonconventional sources (p. 49)

Senate recedes, except that the credit would be retained for gas produced from a tight formation or biomass and for synthetic fuel or gas from coal.

IV.E.4.b. Duty-free entry of alcohol fuels (p. 49)

House recedes with an amendment in the form of a substitute, incorporating language of section 864, H.R. 4800 which permits duty-free entry of (1) ethyl alcohol which has been both fermented and dehydrated in an insular possession or a CBI country, or (2) ethyl alcohol dehydrated in an insular possession or CBI country produced using hydrous ethyl alcohol which is wholly the product of manufacture of any insular possession or beneficiary country having a value not less than 30% in 1987, 60% in 1988, and 75% thereafter of the value of the ethyl alcohol or mixture.

This language contains two grandfather clauses, one for Tropicana in 1987 and 1988 at a 20 million gallon annual cap, and the second for Chemical Fuels in 1987. The House proposal adds to the transition a third grandfather clause for Allied Ethanol in 1987 and 1988 at a 20 million gallon annual cap.

Ethyl alcohol imported for other than fuel uses is excluded from tariff through a certification process with evidence of actual use presented within a reasonable time.

Definition of ethyl alcohol is clarified to include mixtures containing ethyl alcohol which are suitable for use as fuel or in producing a fuel.

This provision would apply to articles entered after December 31, 1986.

TITLE V--TAX SHELTERS; INTEREST EXPENSE

V.C. Nonbusiness interest limitations (p. 53)

House recedes, with drafting correction of coordination with sec. 280A to refer to sec. 280A(e)(1), and other language corrections.

TITLE VI--CORPORATE TAXATION

VI.B. Dividends paid deduction (p. 55)

Senate recedes with modification providing that dividends paid deduction is normalized in the case of utilities using consolidated returns until parent obtains dividend paid deduction. Then, pro-rata computation is utilized for subsidiary.

VI.H. Corporate Taxation: Special Limitations on Net Operating Loss Carryovers (p. 58)

1. General rules.--The general rules are the same in both bills; technical differences are resolved (e.g., single definition of ownership change, aggregation rules for less-than-five-percent shareholders, the attribution of optioned stock if the limitations would apply, and the measure of a corporation's value after a redemption).

2. Certain transfers disregarded.--House recedes with amendments treating stock held by members of a family as held by one person, disregarding stock acquired by ESOPs and ESOP participants if the ESOP holds at least 50 percent of the stock after the acquisition and satisfies certain other requirements, and technical modifications.

3. Rate of return limitation.--Senate recedes with amendments requiring Treasury to publish tax-exempt Federal long-term rate within 30 days of date of enactment, and providing that the rate will be the highest of such rates in effect for any month in the 3-calendar month period ending with the month in which the ownership change occurs.

4. Business continuation requirement.--Senate recedes.

5. Built-in gains and losses.--House recedes with amendment directing Treasury to conduct a study relating to the treatment of depreciation, amortization, depletion, and other built-in deductions and report to the tax-writing committees by January 1, 1989.

6. a. Bankruptcy proceedings.--House recedes with amendments extending the holding period for creditor claims to 18 months, and reducing carryovers that are available

after an ownership change by 50% of the excess of the discharged claim over the value of the stock transferred to the creditors.

b. Financially troubled thrifts.--See title IX, special reorganization rules for troubled thrifts, for House conferees' offer.

7. Investment assets.--Senate recedes with amendment providing exceptions for RICs and REITs, and technical modifications.

8. Capital contributions.--House recedes.

9. Effective date and status of amendments made by Tax Reform Act of 1976.--House recedes, transitional rules left open.

VI.J. Recognition of Gain or Loss in Liquidations (p. 62)

Senate recedes; however:

--Additional effective date relief extending effective date from November 20, 1985 to August 1, 1986 for transactions that had a binding contract for the sale of the company, or substantial completion of liquidation by August 1, 1986. Such transactions must complete by December 31, 1987.

Complete relief (except for ordinary income and short-term gain property) for small, closely held companies on liquidating sales or distributions occurring before January 1, 1989 where liquidation is substantially completed by that date. This replaces all House bill relief for 10 percent shareholders. Such small, closely held companies are those not exceeding $5 million in value and more than 50 percent of whose stock is owned directly or indirectly for a substantial period by no more than 5 individuals.

VI.O. Real Estate Investment Trusts (p. 65-67)

1. General requirements.--House recedes.

2. Asset and income requirements.--House recedes.

3. Definition of rents.--House recedes with provision relating to shared appreciation mortgages.

4. Distribution requirement.--House recedes, with following modifications:

(a) base relief from the distribution requirement on the excess of the amounts taken into income under secs.

1274 or 467 over amounts that would be taken into account under the REIT's method of accounting.

(b) apply to REITS the same provisions applicable to RICs regarding taxable years and spillover dividends.

5. Capital gains.--House recedes.

6. Prohibited transactions.--House recedes, with modification basing alternative transaction safe harbor on percentage (10 percent) of adjusted (e & p) basis of the REIT's assets.

7. Deficiency dividends.--House recedes.

8. Effective date.--House recedes.

VI.P. Mortgage-Backed Securities (pp. 68-70)

House recedes with the following modifications:

(a) No entity level tax is imposed, and all income of the REMIC that is not taken into account by holders of regular interests is taken into account directly by holder of residual interest, except where, as provided by regs, the residual interest has relatively little possibility of gain or loss.

(b) Income in excess of "economic" income of the residual is UBI for tax-exempts, subject to withholding at statutory rate for foreign persons, and may not be offset by NOLs (other than NOLs of thrift institutions). "Economic" income of the residual is determined by using 120 percent of long-term Federal rate.

(c) Loss on the sale of a residual interest would be deferred to the extent that the seller purchases (or has purchased) another residual interest (in any owners' debt pool) within a specified period.

(d) The owners' debt pool provisions would be expanded to include corporations (such as RICs and REITs) that meet the specifications, and "phantom income" generated by owners' debt pools would be subject to the same rules as those for income of a REMIC residual holder in excess of economic income. The effective date of these provisions would be delayed for five years.

(e) Provisions would be added allowing for shelf registration procedures.

(f) Expenses of issuance would be added to basis and recovered as selling expenses of interests disposed of.

(g) The distribution requirement would be eliminated but regulatory authority would be provided to prevent unreasonable accumulations.

(h) Cure procedures for inadvertent disqualification would be provided under regulations.

(i) Modifications would be made to the definition of residual interests to permit mortgage overcollateralization.

(j) Residual interests would receive ordinary income/loss treatment under sec. 582.

(k) The "intention to call" rule would be applied only to the under-accrual of OID.

VI.Q. Regulated Investment Companies (p. 70-71)

The House recedes with modifications as follows:

(a) The calendar year/spillover dividend provisions would provide:

(i) Money market funds distributing monthly (which provide no deferral), and tax exempt funds would be excluded from the provision;

(ii) RICs would be permitted to use any taxable year, but distribution requirement for ordinary income would be based on the calendar year;

(iii) RICs would be required to distribute 95 percent of their ordinary income for the calendar year during such calendar year -- any shortfall may be distributed as a spillover dividend subject to the 5 percent excise tax;

(iv) Appropriate rules will be provided for spillover capital gains dividends.

b. A hedging exception from the "short-short" rule would be provided.

TITLE VII--MINIMUM TAX PROVISIONS

VII.A. Individual Minimum Tax

A.3. Phaseout of exemption amount (p. 73).--House recedes.

4. b. Accelerated depreciation on real

property.--House recedes (grandfathered property).

c. Accelerated depreciation on personal property.--House recedes (grandfathered property).

d. Expensing of intangible drilling costs (p. 74).--Senate recedes.

k. Incentive stock options.--technical change to adjust basis for minimum tax purposes to reflect inclusion of preference.

l. Tax-exempt interest.--Senate recedes. Clarify exception for current refundings as applied to bonds issued as part of a series.

m. Excludable income earned abroad by U.S. citizens.-- House recedes.

o. Installment method of accounting (p. 75).--House recedes. Timeshare exception to the preference is deleted along with the regular tax provision. Preference would apply to same transactions subject to rules concerning debt-financed installment sales.

p. Net losses from passive business activities.--House recedes. Technical change clarifying application of preference to some taxpayers as regular tax. Working interest exception is deleted along with regular tax provision.

q. Net losses from passive farming activities.--farming preference is deleted.

5. Itemized deductions (p. 76).--Senate recedes (charitable contributions of appreciated property and investment interest definition).

9. Foreign tax credit.--Senate recedes.

VII.B. Corporate Minimum Tax

B.3. Phaseout of exemption amount (p. 77).--House recedes.

4. a. Accelerated depreciation on real property.--House recedes (grandfathered property).

f. Accelerated depreciation on personal property.--House recedes (grandfathered property).

g. Expensing of mining exploration and development costs.--Senate recedes.

h. Expensing of intangible drilling costs (p. 78).--Senate recedes.

k. Tax-exempt interest--Senate recedes. Clarify exception for current refundings as applied to bonds issued as part of a series.

l. Excludable foreign sales corporation (FSC) income.--Senate recedes.

n. Charitable contributions of appreciated property.--Senate recedes.

o. Installment method of accounting.--House recedes. Timeshare exception to the preference is deleted along with the regular tax provision. Preference would apply to same transactions subject to rules concerning debt-financed installment sales.

p. Capital construction funds for shipping companies.--House recedes.

q. The use of book income in the Senate proposal is replaced by the use of earnings and profits in a revenue-neutral manner. The definition of earnings and profits will be modified to simplify computations for items acquired or events occurring prior to the effective date, more closely achieve the goals of the Senate's use of book income in its provision, and conform the rules for computing earnings and profits more closely to the policy objectives of the Internal Revenue Code.

6. Adjustment in other years when taxpayer pays minimum tax (minimum tax credit) (p. 79).--House recedes.

7. Incentive credits.--Technical correction providing that income eligible for the sec. 936 credit is not included in minimum taxable income. Open: transition issues.

8. Foreign tax credit.--Senate recedes.

TITLE VIII--ACCOUNTING PROVISIONS

VIII.A. Limitations on the Use of the Cash Method of Accounting (p. 80)

Senate recedes with technical modifications to the definition of qualified personal service corporations providing that the ownership requirement will be considered satisfied if substantially all of the entity's stock is held by employees and stock held by an ESOP or other pension plan will be considered as held by the employees of the corporation.

VIII.C. Installment Sales (p. 82)

House recedes with modifications (a) providing that sales on a revolving credit plan are subject to the proportionate disallowance rule (with a "nine-month" exception), (b) deleting the special election for sales of "timeshares" and residential lots, and (c) clarifying that the provision does not apply to sales of crops and livestock held for slaughter. In addition, installment obligations arising from the sale of trade or business or rental property the selling price of which does not exceed $150,000, or sales of farm property, would not be subject to the proportionate disallowance rule, but the proceeds of any loan for which such obligations are pledged would be treated as a payment on on such obligations.

VIII.G. Taxable Years of Partnerships, S Corporations, and Personal Service Corporations. (p. 86)

House recedes with amendments allowing a 4-year spread to owners of personal service corporations where such owners include more than 12 months of income in a single taxable year as a result of this provision and requiring that personal service corporations not deduct payments to owner-employees prior to the year paid.

TITLE IX--FINANCIAL INSTITUTIONS

IX.B. Interest Used to Purchase or Carry Tax-Exempt Obligations (p. 91)

Senate recedes with the following modifications as to effective dates:

1. The disallowance provision applies for taxable years ending after December 31, 1986, with respect to tax-exempt obligations acquired on or after January 1, 1986. (The transitional rule for written commitments before September 25, 1985, is retained.)

2. Clarify that the 3-year exception for certain governmental obligations is limited to governments (other than States) that reasonably expect to issue, directly or through subordinate governmental entities, not more than $10 million of governmental or section 501(c)(3) obligations during the calendar year.

3. Delete the rule requiring that the purchasing bank be located within the State of the issuer, in order for the 3-year exception to apply.

TITLE X--INSURANCE

X.A. Insurance Products (p. 93 - 94)

3. Policyholder loans.--House recedes. House committee report language regarding single premium policies to be restated in statement of managers with clarification that universal life insurance is not always treated as a single premium policy.

X.C. Property and Casualty Insurance Companies (p. 97 - 100)

1. Treatment of acquisition expenses.--Senate recedes, with amendments adopting Senate bill rules with respect to exclusion of life insurance reserves from the treatment of acquisition expenses, and the requirement of inclusion where the taxpayer ceases to be an insurance company. Title insurance unearned premium reserves are subject to discounting over the period that the unearned premiums are deferred at the rate applicable to property and casualty loss reserves.

2. Treatment of tax-exempt income.--Senate recedes. Retain House bill exception for investments acquired before November 15, 1985, and apply 15 percent rate for taxable years beginning after December 31, 1986.

3. Treatment of loss reserves.--House recedes, with amendments providing that discount rate is 100 percent of midterm AFR; no fresh start is provided for reserve strengthening in taxable years beginning after 1985; the forgiveness of income under the fresh start rule is reduced by existing NOL carryforwards; and extension of payment patterns for long-tail lines is applied without a 5 year maximum.

TITLE XI--PENSIONS AND DEFERRED COMPENSATION; EMPLOYEE BENEFITS; ESOPs

XI.A.2. Qualified cash or deferred arrangements (pp. 103-105)

a. Limit on elective deferrals.--Senate recedes with modifications to provide accounting rules for determining the income on excess contributions.

b. Nondiscrimination requirements.--Senate recedes with modifications to provide (1) accounting rules for determining the income on excess contributions, (2) that distributions of excess contributions from a discriminatory arrangement are not subject to the early withdrawal tax, (3) rules for applying nondiscrimination requirements to combinations of cash or deferred arrangements and defined

contribution plans, and (4) compromise proposal on definition of highly compensated employees.

c. Withdrawal and other restrictions.

(2) Senate recedes with an amendment to adopt the provision in the Senate bill permitting withdrawals in the case of certain sales of subsidiaries or assets. Further, the sale of subsidiaries provision should apply whenever an employee ceases to participate in a cash or deferred arrangement because of the sale of any facility, unit, or subsidiary of an employer sponsoring the plan. Provide a retroactive effective date for this provision, as expanded.

(5) Senate recedes with an amendment to provide a January 1, 1986, effective date for the grandfather rule for public employers.

XI.A.3. Employer matching contributions and employee contributions. (p. 106)

a. Employer matching and employee contributions.--Senate recedes with an amendment to apply a single nondiscrimination test to all employer matching contributions and employee contributions similar to the special nondiscrimination test for cash or deferred arrangements under the House bill.

b. Excess contributions.--Same in both bills with a modification to provide accounting rules for determining income on excess contributions.

XI.A.5. Deferred annuity contracts (p. 109)

a. Investment earnings.--Senate recedes with an exception for qualified funding assets purchased by structured settlement companies (similar item in President's proposal).

XI.B.2. Minimum participation requirement (p. 115)

House recedes with an amendment to provide appropriate transition rules for existing plans.

XI.B.3. Nondiscrimination rules applicable to tax-sheltered annuities (p. 115).

Senate recedes with an amendment clarifying the definition of an employer for purposes of the rule relating to elective contributions.

XI.B.4. Integration with Social Security (pp. 116-117)

House recedes with amendments to provide that, under an

offset plan, the offset is limited to no more than a percentage of an employee's primary insurance amount under social security and that the permitted disparity is not greater than the disparity permitted under present law.

XI.B.5. Definition of highly compensated employees (p. 117)

Compromise proposal from employee benefit nondiscrimination rules, with indexing of dollar thresholds conformed to increases in Consumer Price Index.

XI.B.7. Includible compensation (pp. 117-118).

House recedes on amount with an amendment to make the changes applicable for section 404 purposes; Senate recedes on method of indexing.

XI.B.9. Vesting (pp. 119-120)

House recedes with amendment to provide appropriate conforming amendments to Title I of ERISA pursuant to ongoing consultation with staff of Committee on Education and Labor.

XI.C.3. Uniform tax treatment of distributions (pp. 123-125).

c.1. Basis recovery.--Pre-annuity starting date.--Senate recedes, except House recedes on Senate rule on lump-sum distributions of employee contributions (item in President's proposal) and on Senate rule to limit partial distribution rollovers to individuals who separate from service.

XI.D.1. Tax deferral under qualified plans (pp. 127-128)

a. Defined contribution plans.--House recedes on limit with an amendment to clarify that contributions made by retired nonkey employees for retiree medical coverage are not be treated as annual additions. Senate recedes on indexing.

b.1. Defined benefit plans.--Limits on benefits.--House recedes with modifications to grandfather the benefits of employees of public employers whose benefits cannot be reduced even on a prospective basis under the constitution or laws, as in effect on July 31, 1986, of the employer maintaining the plan. Senate recedes on indexing. Special rule for police and firefighters open.

b.2. Defined Benefit plans. Phase in of limit.--Same in both bills. Amendment adopted to provide exceptions for nonabusive benefit increases.

c. Limits on benefits from more than one plan.--Senate recedes with an amendment to grandfather benefits accrued

before August 1, 1986. (Item in President's proposal.)

XI.D.2. Deductions for contributions to qualified plans (p. 129-130)

a.1. Profit-sharing and stock bonus plans.--Coordination with social security integration.--House recedes.

b. Combination of pension and other plans.--Senate recedes with an amendment clarifying the rules applicable to fully insured plans (similar item in President's proposal).

XI.D.3. Asset reversions under qualified plans (p. 131)

House recedes on the general rule with amendments to clarify what an "indirect recovery" of excess assets is for purposes of the excise tax; Senate recedes on ESOP exception.

XI.F.1. Statutory employee benefit exclusions (p. 136)

a.1. Prepaid legal services.--Senate recedes with an amendment to provide a transition rule to allow elections of group legal services under a cafeteria plan for all of 1986, rather than only for reimbursements after the date of enactment.

XI.F.2. Nondiscrimination requirements for employee benefit plans (pp. 137-145)

Under the compromise proposal, employee benefit plans would be subject to an eligibility test and a benefits test, applicable to each type of employee benefit. Both tests could be satisfied on a line of business or operating unit basis. The tests would apply to all employee benefits other than qualified tuition reductions (sec. 117(d)) and miscellaneous fringe benefits (sec. 132). In applying the tests to health plans, employees with other health coverage could be disregarded, and family health coverage could be tested separately. In the case of group-term life insurance, the nondiscrimination rules could be applied to the value of coverage provided, expressed as a percentage of pay. In the case of a discriminatory plan, generally only the discriminatory portion of a benefit provided to a highly compensated employee would be taxed. Present-law concentration tests would continue to apply. The provisions would be effective for taxable years beginning after December 31, 1987.

XI.F.3. Benefits provided under a cafeteria plan (p. 145)

Under the compromise proposal for employee benefit plans, cafeteria plans would be subject to the general nondiscrimination rules. Generally, different types of

benefits could be aggregated for purposes of satisfying the benefits test.

XI.F.4. Faculty housing (p. 145-146)

House recedes with a technical modification to determine imputed rental value of qualified lodging and inclusion in statement of managers of the language in the Senate Finance Committee report relating to treatment of faculty housing for prior years.

XI.G. Employee Stock Ownership Plans (ESOPs) (pp. 148-153)

Senate recedes, but require ESOPs to satisfy the general vesting requirements rather than the special ESOP vesting rules in the House bill.

Title XII--Foreign Tax Provisions

XII.A.1.b.5. Separate foreign tax credit limitations (p. 155)

As to controlled foreign corporations, House recedes with amendment treating taxable interest payments from controlled foreign corporations to related persons as consisting of passive income to the extent of the payor's passive income (computed prior to the operation of Subpart F) and with other technical modifications. Adopt a separate foreign tax credit limitation for each noncontrolled foreign corporation that pays dividends eligible for deemed paid foreign tax credit (with separate treatment for amounts attributable to high withholding tax interest). Interest received from noncontrolled foreign corporations would be treated as passive income. Rents and royalties received from noncontrolled foreign corporations would be treated as passive or active without reference to look-through rules.

XII.B.1. Income from sale of property (p. 159)

(a) Allow foreign persons related to U.S. persons to generate foreign source income on sales of personal property produced in the United States only if for use, consumption or disposition outside the United States.

XII.B.4. Dividend and interest income (p. 163)

(a)(1) Dividends paid to foreign persons by a corporation 80 percent of whose income (or whose group's income) is active foreign business income: House recedes with a 10-percent floor on the amount subject to withholding. Other dividends: Senate recedes.

Interest paid by a corporation meeting the 80-percent active foreign business test: if to unrelated persons,

foreign source; if to related persons, House recedes, with a 10-percent floor on the amount subject to withholding in the case of foreign payees. Other interest: U.S. source.

XII.D.1. Possession tax credit (p. 169)

(a)(2) Same as in both bills, but with a technical correction to the profit split option clarifying that the denominator of the fraction used to apportion product area research expenditures to products within such product area is gross income from such product area (rather than gross income from all product areas).

XII.D.8. Foreign investment companies (p. 174)

(1) House recedes.

(2) House recedes with amendment extending basis rules now applicable to FICs to passive funds.

(3) Tax is imposed on exact amount of the investor's share of a passive fund's earnings only if the fund elects look-through treatment (described in (7) below).

(4) Allows current payment of tax on undistributed income only for investors in funds electing look-through treatment (described in (7) below).

(5) Identical.

(6) House recedes.

(7) If a passive fund elects by the first post-enactment year of investment to annually provide adequate U.S. tax data, then (i) capital character of income flows through to investors, (ii) gain attributable to appreciation unrealized at the passive fund level is treated as capital, and (iii) income is treated as earned by the investor in the year that the PFIC earned it.

Technical Corrections to the Consolidated Omnibus Budget Reconciliation Act of 1986 (COBRA)

Include in H.R. 3838 technical amendments to the continuing health care provisions of COBRA contained in the House budget reconciliation bill, with appropriate conforming amendments to Title I of ERISA.